

University of Mississippi
eGrove

American Institute of Accountants

Deloitte Collection

1940

Reports of Committee on Terminology; Accounting Research Bulletin, no. 07

American Institute of Certified Public Accountants. Committee on Accounting Procedure

Follow this and additional works at: https://egrove.olemiss.edu/dl_aia



Part of the [Accounting Commons](#), and the [Taxation Commons](#)

Recommended Citation

American Institute of Certified Public Accountants. Committee on Accounting Procedure, "Reports of Committee on Terminology; Accounting Research Bulletin, no. 07" (1940). *American Institute of Accountants*. 348.
https://egrove.olemiss.edu/dl_aia/348

This Article is brought to you for free and open access by the Deloitte Collection at eGrove. It has been accepted for inclusion in American Institute of Accountants by an authorized administrator of eGrove. For more information, please contact egrove@olemiss.edu.

Accounting Research BULLETINS

November 1940

No. 7
(Special)

Reports of
Committee on Terminology

★
Issued by the Committee on Accounting
Procedure, American Institute of Accountants,
13 East 41st Street, New York, N. Y.

Copyright 1940 by American Institute of Accountants

FOREWORD

BELOW are presented two reports of the committee on terminology, which, as stated in the first report, has been constituted from the committee on accounting procedure.

It is thought convenient to issue these reports in a form to be included in the Research Bulletins binder. It should be noted, however, that while the committee on accounting procedure approved the reports for presentation to the Council and has now authorized publication of these reports, they do not represent formal pronouncements of that committee, as preceding bulletins do.

REPORT OF THE COMMITTEE ON TERMINOLOGY MIDYEAR, 1940

To the Council of the American Institute of Accountants:

GENTLEMEN:

The committee on terminology has this year been constituted from the membership of the committee on accounting procedure. This emphasis on the relation between the tasks of the two committees suggests a re-examination of the work and program of the committee on terminology.

The committee was constituted in 1920 and entered on the task of compiling a vocabulary of words and expressions used in accounting and gradually preparing definitions thereof. In 1931 the committee brought together definitions which had been formulated, in a volume which was published by the Institute under the title *Accounting Terminology*, but without official approval and with emphasis on its tentative character. In 1932 a differently constituted committee prepared another and apparently quite independent tentative compilation which was never published.

A comparison of the two reports shows how vain was the hope expressed by the committee of 1931 that its definitions would be accepted

as representing "the sense of the great majority of the leading accountants." It also indicates very clearly how loose and variable was the accounting use of terms.

In the years that have since elapsed events have forced accountants to give more careful consideration to the use of words, as the responsibilities that may flow from inaccurate usage have become more serious and manifest.

An examination of the reports above referred to suggests that the words and phrases defined fall into four classes.

First, there are words or phrases that are fundamental and are used in accounting in senses more or less at variance with the senses which attach to them in the public mind. (Value, assets, liabilities, surplus, etc.) Second, there are a small number of purely technical terms developed by accountants and unfamiliar to the public, such as balance sheet, double entry. Third, there are words originating in other fields, particularly law and business, with which the accountant is frequently concerned. Fourth, there are terms used in auditing as distinct from accounting.

This committee believes that the words or phrases in the first class, and a few in the second class, should be those to which the efforts of the committee should be primarily directed.

As a field of activity or thought extends, and a need for new modes of expression arises, the need may be met by the development of new words, or by extending the meaning of words already in use. Either course has its dangers; in the one case that of not being understood, in the other that of being misunderstood. Where, as in the case of accounting, the need arises from the growth of an old activity, the second alternative is likely to be adopted more freely than the first and the resulting danger of being misunderstood is very real.

The first task of the committee might therefore well be to prepare a discussion of the specialized usage in accounting of common terms, that would be more extensive than mere definitions and might perhaps include suggestions for modifications of present practice, with the object of minimizing misunderstandings. Such a discussion might not only be circulated in the profession, but brought to the attention of publishers of general dictionaries with a view to recognition of the special usages in the new editions of such works.

To illustrate its point, the committee draws attention to the present uses in accounting of the words "value," "assets" and "liabilities." A correct understanding of these uses is fundamental to the definition of many other accounting terms.

The report of 1931 lists thirty-one phrases using the general term

Report of the Committee on Terminology

“value.” But although the general dictionaries recognize no use of the word “value” in a pecuniary sense except as connoting worth, and although many of the thirty-one definitions implicitly assume the use of that word in a different sense, the report gives no explicit recognition to such use nor any definition of “value” as used in accounting. It cannot be denied that today “value” is used in accounting to describe not necessarily worth but some attribute of a thing (most commonly, but not always, property), capable of being expressed in terms of money, the particular attribute being normally indicated by a qualifying adjective (e.g., book value, replacement value, etc.).

Furthermore in accounting, “values” as thus broadly defined, although not homogeneous, may be aggregated or deducted from one another. Thus, it is a universally accepted practice to add the cost value of one asset to the market value of another, and to deduct from the sum the nominal value of a liability to arrive at a net figure. (The use of the term “net worth” to describe this figure still persists, although it is becoming less common.) This procedure, although open to obvious criticism of its mathematical propriety, possesses so many practical advantages and is so well established both here and abroad, in accounts subject to regulations as well as in accounts not so subject, that it is not likely to be abandoned.

To continue the illustration, in a realistic view one must recognize that the words “assets” and “liabilities” are in accounting usage often no more than substitutes for Dr. and Cr. as the headings for the two sides of a balance sheet, and further that not all the items carried under those heads are assets or liabilities in the ordinary sense of those words, and not all the items that are assets or liabilities in the ordinary sense are commonly included under these heads. Thus in one case goodwill, which may be the most valuable of assets, may not appear, but in another discount on common stock may appear under the head of assets.

It cannot be suggested that the special uses in question are chargeable as misuses to the accounting profession, because they are at least as common in governmentally regulated accounting as in accounting not so regulated.

In passing it may be noted that while the use of “assets” and “liabilities” as balance sheet headings is more common in America than in England, the first volume of the *Oxford Historical Dictionary*, published in England in 1888, recognizes it. In the course of the definition of assets it states: “The Dr. and Cr. sides of a Balance Account contain ‘assets’ and ‘liabilities’ respectively.” American general dictionaries apparently do not recognize this usage.

As noted in the report of 1931, "assets" (a singular noun) originally meant a sufficiency of property to meet an obligation; then by extension it was used in the plural to mean the property itself, still with the question of sufficiency in mind. Since it was applied in relation to debts and legacies, the measure of an asset was of course its estimated realizable value. Thence it came into use in double entry balance sheets in which the "values" of assets are not necessarily measured by worth, as they were in the old single entry statements of net worth.

The report of 1931 does not explicitly recognize the use of the word "asset" as merely a heading for one side of a balance sheet, but it does so implicitly in that it mentions (though it disapproves of the practice) that even a deficit is "not infrequently" included in the total assets.

The report of 1932 gives as one definition of liabilities: "All debts owing plus net worth. In this sense it is used as a balance sheet heading." The report of 1931 does not recognize this usage. Moreover, the earlier report indicates that liabilities include forms of obligations other than debts, and thus is perhaps more accurate than the later report.

The word "surplus" falls in a somewhat different category, the general definition being so broad that any accounting use must come within it. The *Historical Dictionary* defines it as "that which remains over and above that which has been taken or used." The objective of the Institute in this case should clearly be to make the significance of the word as used in accounting more precise and uniform.

The failure of accountants to emphasize the conventional uses of such terms has given rise to much unwarranted criticism of accounts and of the profession. Students from other fields discovering these uses, and finding no extensive recognition of them in the literature of the profession, are apt to regard as revelations and as grounds for severe criticisms what are really truisms accepted by regulatory bodies, accountants and business men generally.

A question may no doubt be raised whether all such uses are necessary or expedient or whether some should be abolished. This would seem to be a question for the committee on accounting procedure to consider.

The committee on terminology asks the approval of the Council for the preparation of a monograph on specialized accounting uses of common words or phrases, to be prepared in cooperation with the committee on accounting procedure and with the assistance of the research staff. It contemplates that such a monograph should be brought to the notice of compilers of dictionaries, with a view to

Report of the Committee on Terminology

recognition being accorded to the special uses in new editions of such works.

Respectfully submitted,

GEORGE O. MAY, *Chairman*

GEORGE D. BAILEY

VICTOR H. STEMPEL

May 14, 1940

REPORT OF THE COMMITTEE ON TERMINOLOGY
OCTOBER, 1940

To the Council of the American Institute of Accountants:

GENTLEMEN:

In its mid-year report, this committee referred especially to the difficulties which arise from the use of special terms in accounting in a technical sense as contrasted with the sense attaching to the same words in the public mind. It was proposed that this committee proceed to a discussion of some of the more common words in the hope of clearing up some of the ambiguities that exist.

The committee has been requested by the Executive Committee to suggest a definition of public accounting, and the work of the committee on accounting procedure has created a demand for a definition of accounting principles. In this report, therefore, the committee offers a discussion and suggested definitions of accounting, accountancy, public accounting, and accounting principles.

Accounting—Accountancy

No words are employed more commonly than these, either in the practice or in the teaching of the subject, and while it may at first seem superfluous to discuss them, your committee believes that many differences that arise in accounting writings have their roots in different conceptions of these basic terms. A careful consideration of these words will therefore add to understanding, not only among accountants themselves, but also among those outside the profession who have to do with accounting.

The committee suggested that one result of such discussions might be to bring the special uses of accounting terms, as against their general uses, to the attention of publishers of general dictionaries. That publishers have not hitherto given adequate attention to these special uses is very evident from their treatment of the words now under consideration. The Standard ¹ contains no definition of "accounting,"

¹ Funk & Wagnall's *New Standard Dictionary* (1939).

though it uses the word in defining the verb "account" as "To furnish or receive an accounting." For "accounting"—the noun—the more formal "accountancy" is made to serve, and is defined as "The work or art of an accountant." Turning therefore to "accountant," in the hope of finding a definition which did not use the word to be defined, we learn that he is "one who keeps, examines, or is skilled in accounts; one whose business is to keep or examine books of a mercantile or banking house or in a public office."

As if to compensate for the omission of any definition of "accounting," this dictionary adds a definition of "accountics," which is said to be "the science or art of keeping accounts; bookkeeping." We note that "account" is still the root word, and so turn to it to find that it is "a record or statement of debits and credits, of receipts and expenditures or of other business transactions, etc.; any methodical enumeration or reckoning; computation."

This definition, or series of definitions well illustrates the confusion between the general and the special meanings of these words. The first half is obviously intended to define "account" in its special and narrow sense as accountants know it, but the result is a very inadequate statement, of which the writer must have been conscious when he trailed off into "other business transactions, etc." The other two definitions, "any methodical enumeration or reckoning; computation." are the general meanings of the word and need not concern us.

It is not necessary to discuss the definitions in all the dictionaries at the same length, but only to note one or two variations of practice. Webster's ¹ definition of "account" is "a reckoning, computation, calculation, enumeration. The preparation of a record of transactions or the like." This shows only broad traces of the meaning of an account in the accountant's sense, but the reverse is the case with the elaborate definition of "accounting," namely: "The art or system of making up or stating accounts; the body of scientific principles underlying the keeping and explanation of business accounts. The application of such principles in practice. Accounting explains the results furnished by the bookkeeper and draws the necessary inferences as to the condition and conduct of the business, a function emphasized in the phrase public accountant." It furnishes a fairly complete description of "accounting" in the accountant's sense, but gives no inkling of any general sense in which the word may be used.

Turning from the general dictionaries to accounting literature, a number of definitions are noted, which form a somewhat variegated pattern.

¹ Webster's *New International Dictionary* (1940).

Report of the Committee on Terminology

In *Accounting Terminology*, the published work of an earlier terminology committee, "Accountancy" is said to be "The profession dealing with" the several phases of accounting work. Then follows: "The objective is the statement of financial affairs in such a manner as to give due effect to every material factor, making available all the light that past accounts can give to assist in planning for the future." "It consists of two processes: synthesis, such as is used in building up or designing accounts; and auditing, the object of which is to analyze and verify the results submitted."

This is somewhat confusing. The first clause seems to refer to the men who carry on accounting work, but the second and third paragraphs plainly comprise the subject matter of accounting. There is nothing to be gained by identifying—or confusing—accountants with accounting, though they are so obviously related.

The English work, Dawson's *Accountant's Compendium* (1930), gives a fairly comprehensive definition of "Account," but none for accounting, accountant, accountancy, chartered accountant or certified public accountant—illustrating once more how little English accountants are given to generalizing about their own work, and how pragmatic is their attack.

A study of accounting texts yields the following:

From *Essentials of Accounting*, by W. A. Paton, page 3: "In terms of relation to the operation of the business enterprise accounting may be defined as the body of principles and the technical mechanism by means of which the economic data of the particular concern are classified, recorded and periodically presented and interpreted, for the purpose of effective control and administration."

From *Principles of Accounting*, by John Raymond Wildman, preface: "Accounting may be defined as that science which treats of the systematic compilation and presentation in a comprehensive manner, for administrative purposes, of the facts concerning the financial operations of a business organization."

"Accountancy is most aptly defined in the 'Certified Public Accountant Syllabus' issued by the New York Education Department as, 'A profession, the members of which, by virtue of their general education and professional training, offer to the community their services in all matters having to do with the recording, verification and presentation of facts involving the acquisition, production, conservation and transfer of values.'"

Proposed Definition of "Accounting"

It would seem that the essential features of all these definitions

might be stated shortly as follows:

"Accounting is the art of recording, classifying and summarizing in a significant manner and in terms of money, transactions and events which are, in part at least, of a financial character, and the results thereof."

The committee accordingly submits this definition for the consideration of accountants and others who may be interested. If a comprehensive term is required to designate those who practise this art, the appropriate expression would seem to be the "accounting profession," and not to make a single word connote both the accountant and his work.

Comment on Proposed Definition

The definitions of Professor Paton and Mr. Wildman imply the more obvious comment upon the foregoing definition. Mr. Wildman's definition calls accounting a "science," whereas your committee prefers to regard it as an "art." By calling accounting a science attention is directed to the ordered classifications used as the accountant's framework, and to the known body of facts which in a given case are fitted into this framework. The committee would not ignore these aspects of accounting, but would emphasize rather the creative skill and ability which the accountant brings to the application of his knowledge to a given problem. Webster and the Standard agree that in part art is science, and that art adds the skill and experience of the artist to science. In this sense the committee would call accounting an art.

In Professor Paton's definition special mention is made of "the body of principles" which should govern the accountant's work. The committee implies the same thing, without express mention. Every art must work according to a body of applicable rules, but it also reserves the right to depart from the rules whenever it can thereby achieve a better result. It is desirable that the accountant conceive of his work as a complex problem to be solved, of his statements as creative works of art, and that he reserve to himself the freedom to do his work with the canons of the art constantly in mind and as his skill, knowledge and experience best enable him.

Public Accounting

It would be a mistake to identify the term "public accounting" too narrowly with "auditing." Auditing itself may be public or private, the latter being commonly known as internal audit. "Public accounting" includes everything comprised in "accounting" when it stands alone, and the word "public" indicates only some attribute of the

Report of the Committee on Terminology

agent who performs the accounting, which may be any form of accounting work. That attribute is indicated in Webster's definition of a public accountant as "An accountant whose services are available to the public," and still further in his definition of "certified public accountant," the latter being "An accountant who has met the requirements of the State Law, and has been given a State certificate, and is permitted to use the designation C.P.A. . . ." So far so good, but when it is added ". . . in England called Chartered Accountant" the definition ceases to define.

It seems sufficient to define "public accounting" as "The practice of this art (accounting) by men whose services are available to the public for compensation. It may consist in the performance of original work, in the examination and revision of the original work of others (auditing), or in rendering of collateral services for which a knowledge of the art and experience in its practice create a special fitness."

In addition to defining public accounting, it may be well to distinguish between that part of the work of the profession which is affected with a public interest and therefore naturally subject to the police powers of the State, and that which is not so affected. For this purpose, the language of the proposed provision of the New York bill put forward in January, 1940, by the New York State Society of Certified Public Accountants would seem to be appropriate. That bill contained the following definition, "As used in this article: (1) the 'practice of public accountancy' is defined as follows: A person engages in the practice of public accountancy who, holding himself out to the public as an accountant, in consideration of compensation received or to be received by him, offers to perform or does perform, for other persons, services which involve the auditing or verification of financial transactions, books, accounts or records, or the preparation of, or the reporting over his signature of financial, accounting, and related statements, intended for publication or for the purpose of obtaining credit, or to influence any stockholder or creditor of any corporation, or to influence any person or persons other than those who procured the preparation, certification or verification, subject, however, to the provisions of section fourteen hundred and eighty-five-a hereof;".

Accounting Principles

It is next proposed to consider the nature of the body of rules, the guides to conduct, which have already been referred to as governing, or at any rate assisting, the accountant's work. Whether these rules should be called "principles" is the question.

Webster, The Standard, and The New English Dictionary agree in giving at least three orders of definitions of "principle." The first is "source, origin, or cause," which is of little help to accountants except as it emphasizes the primary character of some principles. The second class of definitions, as given in the New English Dictionary, is "A fundamental truth or proposition on which many others depend; a primary truth comprehending or forming the basis of various subordinate truths." The third is: "A general law or rule adopted or professed as a guide to action; a settled ground or basis of conduct or practice . . ."

This third definition comes nearest to describing what most accountants, especially practising accountants, mean by the word "principle." Initially, accounting rules are mere postulates derived from experience and reason. Only after they have proved useful, and become generally accepted, do they become principles of accounting. But in discussion the word is often invested with an aura of sanctity, arising out of its more fundamental meanings, thus leading many to attribute to the rules of conduct called principles a greater force and a more universal and permanent validity than most of them were ever intended to have. It is not convenient, either in conversation or in writing, to add "(meaning number three)" each time the word "principle" is used, though that essentially is the fact.

The Investment Company Act of 1940 uses (in Sec. 19) the expression "good accounting practice." Objection to this expression has been taken by laymen in the past on the ground that it applies the test of what is rather than of what ought to be, and implies that there is not one best practice, but possibly many that are good. In both respects, however, it is realistic, and since the Congress has used it, the Institute might well do so. The obvious objection is that the phrase "generally accepted accounting principles" is used in the standard form of auditor's report or certificate and confusion would result from attempts to effect a change. At the moment this objection may well be controlling, but if the phrase "accounting principles" is to be retained, every effort should be made to establish clearly the extent and the limits of the significance of the phrase.

In so far, therefore, as "principle" continues to be a necessary word to accounting discussion, care should constantly be taken to make it clear that, as applied to accounting rules of practice, it does not connote a law of that high order from which there is no appeal. An accounting principle is not a principle in the sense that it admits of no variation, nor in the sense that it cannot conflict with other principles. The analogy to principles of law suggests itself; they frequently

Report of the Committee on Terminology

conflict with each other, and in many cases the question is which of several partially relevant principles has determining applicability. This situation is so familiar in law that it is surprising to find it giving rise to any question in accounting.

Respectfully submitted

GEORGE O. MAY, *Chairman*

GEORGE D. BAILEY

VICTOR H. STEMPE

October 14, 1940